Board of Water and Light - City of Lansing, Michigan Enterprise Fund

Financial Report

With Additional Information

June 30, 2004

plante moran

Michigan Dept. of Treasury
496 (2.04)

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type: ☐ City ☐ Township ☐ Village ☒ Other	Local Government Name: Board of Water and Light - City of Lansing, Michigan Enterprise Fund	County: Ingham County
Audit Date: June 30, 2004	Opinion Date: September 3, 2004	Date Accountant Report Submitted To State:

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

☒ Yes ☐ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.

☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).

☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).

☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.

☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132])

☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.

☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).

☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).

☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:	**Enclosed**	**To Be Forwarded**	**Not Required**
The letter of comments and recommendations.	☒	☐	☐
Reports on individual federal assistance programs (program audits).	☐	☐	☒
Single Audit Reports (ASLGU).	☐	☐	☒

Certified Public Accountant (Firm Name): **PLANTE & MORAN, PLLC**			
Street Address: 1111 Michigan Avenue	City: East Lansing	State: Michigan	ZIP: 48823
Accountant Signature: Plante & Moran, PLLC		Date: September 3, 2004	

Board of Water and Light - City of Lansing, Michigan

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Independent Auditor's Report

Honorable Mayor, Members of City Council,
and Commissioners of the
Board of Water and Light

We have audited the basic financial statements of the Board of Water and Light - City of Lansing, Michigan Enterprise Fund (the BWL) as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the BWL's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 13 to the financial statements, the financial statements referred to above present only the Enterprise Fund of the BWL. The financial statements do not include financial data for the Board of Water and Light trust funds, which accounting principles generally accepted in the United States of America require to be reported with the financial data of the BWL's Enterprise Fund. As a result, these financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the BWL as of June 30, 2004 and 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Enterprise Fund of the BWL as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Honorable Mayor, Members of City Council,
and Commissioners of the
Board of Water and Light

The Management's Discussion and Analysis on pages 3 through 6 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise BWL's basic financial statements. The additional information on pages 38 through 41 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

As discussed in Note 15 to the financial statements, during the year ended June 30, 2004, the BWL elected for the early adoption of Governmental Accounting Standards Board (GASB) No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

As discussed in Note 16 to the financial statements, an overstatement of the previously reported book value of the Ottawa Station for the years ended June 30, 2003 and 2002, was discovered by the Company's management during the current year. Accordingly, the net assets of the BWL as of July 1, 2002 have been restated to correct the overstatement.

Plante & Moran, PLLC

September 3, 2004

This section explains the general financial condition and results of operations for the Lansing Board of Water and Light (BWL). The BWL includes the consolidated operations of the water, electric, and steam utilities. The Notes to Financial Statements beginning on page 12 are essential reading for a complete understanding of the financial and operational results for fiscal year 2004.

Overview of Business - The BWL owns and operates an electric system, which generates, purchases, and distributes electric power and energy, and provides electric service to over 99,000 residential, commercial, and industrial customers in the Greater Lansing Area. The BWL generated 74 percent of its retail and wholesale sales from existing generation assets and purchased additional electric generation through its membership in the Michigan Public Power Agency's partial ownership of Detroit Edison's Belle River Plant.

The BWL owns and operates water wells, a raw water transmission system, water conditioning facilities, and an extensive water distribution system serving potable water to over 56,000 residential, commercial, and industrial customers in the Greater Lansing Area.

The BWL owns and operates steam generation boilers, a steam transmission and distribution system serving 266 customers, and a chilled water facility and distribution piping system serving 13 customers in the City of Lansing.

Capital Expenditures

Capital expenditures are driven by the need to expand or maintain the generation, transmission, and distribution systems of the BWL to meet growing customer utility needs and to maintain a satisfactory level of service reliability. The BWL invests essentially all revenues not paid out for operations and maintenance expense, nonoperating expenses, or debt principal back into capital improvements for the water, electric, and steam systems. Total capital expenditures were approximately $42 million in fiscal year 2004, compared to $36 million in fiscal year 2003.

The BWL pays a portion of the cost of its capital expenditures from internally generated funds and a lesser portion from the proceeds of revenue bonds that are issued from time to time.

Detailed financial information for the separate utilities of water, electric, and steam can be found in the Additional Information section beginning on page 38.

Condensed Financial Information

June 30	2004	2003	Percentage Change
	(Dollars in millions)		
Composition of Net Assets			
Utility plant	$ 527.7	$ 519.5	1.6%
Other assets	157.6	159.3	-1.1%
Total assets	$ 685.3	$ 678.8	1.0%
Long-term liabilities	$ 181.6	$ 182.6	-0.5%
Other liabilities	35.2	33.1	6.3%
Total liabilities	$ 216.8	$ 215.7	0.5%
Invested in capital assets	$ 354.6	$ 357.9	-0.9%
Restricted for debt service	61.0	43.4	40.6%
Unrestricted	52.9	61.8	-14.4%
Total net assets	$ 468.5	$ 463.1	1.2%

Utility plant increased by the net amount of $8.2 million. This was due to capital expenditures for expansions of the water distribution system and the conversion of the Erickson Plant to Powder River Basin (PRB) coal, net of annual depreciation expense and the expensing of environmental costs previously capitalized.

Other assets decreased slightly due to reduced receivable and inventory levels. This decrease was partially offset by the establishment of regulatory assets (Note 6).

Invested in capital assets decreased $3.3 million due to the increase in utility plant, which was more than offset by the use of construction bond funds, and repayment of bonded debt.

The increase in restricted for debt service is due primarily to an increased cash balance in the Operating and Maintenance Fund.

The unrestricted equity decreased $8.9 million due to reduced working capital requirements.

Condensed Financial Information (Continued)

June 30	2004	2003	Percentage Change
	(Dollars in millions)		
Results of operations			
Operating revenue	$ 216.7	$ 222.5	-2.6%
Operating expenses	210.9	198.7	6.1%
Nonoperating expense, net	3.5	5.4	-35.2%
Income before extraordinary items and capital contributions	2.3	18.4	-87.5%
Extraordinary items	-	15.2	-100.0%
Capital contributions	3.2	5.5	-41.8%
Change in net assets	$ 5.5	$ 39.1	-85.9%

Operating revenues decreased primarily due to lower sales related to moderate weather conditions. Revenues were also reduced since the reduced fuel costs related to the conversion to PRB coal were directly passed through to customers in the form of reduced rates.

In spite of the decreased energy costs, operating expenses increased $12.2 million primarily due to:

- The write down of Ottawa station, $3.3 million
- Previously capitalized environmental remediation cost, $3.0 million
- Increased maintenance cost at Eckert and Erickson stations, $2.9 million
- Increased medical insurance costs, $1.9 million

Nonoperating expense, net decreased by $1.9 million. The sale of emission credits for $5.4 million accounted for the majority of the net decrease; this was offset somewhat by decreased interest earnings.

Income before extraordinary items and capital contributions for the fiscal year ended June 30, 2004, was $2.3 million compared to $18.4 million for the previous year.

The decrease in capital contributions is due primarily to a decreased level of expansion of the water utility distribution system.

The decrease in change in net assets is the result of income before extraordinary items and capital contributions, as noted above.

Significant Accounting Policies - The BWL no longer applies SFAS No. 71 *Accounting for the Effects of Certain Types of Regulation* to certain items. The extraordinary item in fiscal year end 2003 above, relates to accounting adjustments required by this change. Please see Note 6 for a detailed explanation.

Budget - The BWL Commissioners approved a $202 million operating expense budget for fiscal year 2004. Actual expenses were $211 million or 5.0 percent more than budget. The increase was mainly due to the write-down of Ottawa station to its appraised value, environmental remediation expenses, and increased maintenance expenses at electric production facilities. The net capital improvement budget was $47 million for fiscal year 2004; actual net capital expenditures were $39 million or 83 percent of the capital budget.

Financing Activities

During fiscal year 2004, revenue bonds in the amount of $29,830,000 were issued to refinance the 2001A and a portion of the 1999A revenue bonds related to the Chilled Water Facility.

During fiscal year 2003, revenue bonds in the amount of $24,130,000 were issued to cover the cost of complying with environmental regulations related to NOx compliance. Also during fiscal year 2003, revenue refunding bonds in the amount of $18,920,000 were issued to refinance the outstanding portion of the 1994A revenue bonds. Please see Note 5.

Assets

	June 30 2004	June 30 2003
Current Assets		
Restricted cash and cash equivalents (Notes 4 and 11)	$ 59,139,779	$ 43,777,513
Investments (Notes 1 and 11)	21,320,429	21,550,417
Accounts receivable, net (Note 1)	17,895,640	20,689,642
Estimated unbilled accounts receivable (Note 1)	9,497,637	9,971,307
Inventories (Note 1)	10,821,279	13,032,688
Other	976,689	913,928
Total current assets	119,651,453	109,935,495
Other Assets		
Long-term receivable (Note 6)	17,773,665	17,566,365
Deferred amortization of Central Utilities Complex (Note 6)	1,521,933	-
Deferred environmental remediation (Note 6)	4,623,000	-
Other	1,144,497	1,030,456
Total other assets	25,063,095	18,596,821
Noncurrent Restricted Assets (Notes 4 and 11)	12,920,317	30,711,796
Utility Plant (Note 1)		
Water	164,316,737	153,828,264
Electric	534,561,936	500,217,286
Steam	86,346,324	85,787,027
Common facilities	63,868,106	64,287,154
Central utilities complex	76,079,000	76,079,000
Total	925,172,103	880,198,731
Less accumulated depreciation	426,070,902	397,484,230
Total	499,101,201	482,714,501
Construction-in-progress (Note 3)	28,568,345	36,812,967
Total utility plant	527,669,546	519,527,468
Total assets	$ 685,304,411	$ 678,771,580

See Notes to Financial Statements.

	June 30	
	2004	2003
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 15,051,834	$ 12,108,278
Current portion of long-term debt (Note 5)	8,259,708	8,902,675
Accrued payroll and related taxes	2,679,435	2,921,911
Customer deposits	879,292	866,323
Accrued compensated absences (Note 1)	3,278,936	3,052,022
Accrued interest	4,979,374	5,208,813
Total current liabilities	35,128,579	33,060,022
Deferred Revenue	-	778,075
Compensated Absences, less current portion (Note 1)	7,238,157	6,608,368
Deferred Amortization of Central Utilities Complex	88,067	88,067
Other Long-Term Liabilities		
Workers' compensation	1,212,796	1,154,748
Environmental remediation liability	4,623,000	-
Arbitrage rebate requirement (Notes 4 and 12)	53,516	491,560
Other	888,031	224,865
Total other long-term liabilities	6,777,343	1,871,173
Long-Term Debt, less current portion (Note 5)	167,500,837	173,294,131
Total liabilities	216,732,983	215,699,836
Net Assets		
Invested in capital assets	354,609,032	357,940,076
Restricted for debt service (Note 4)	61,046,841	43,367,363
Unrestricted	52,915,555	61,764,305
Total net assets	468,571,428	463,071,744
Total liabilities and net assets	**$ 685,304,411**	**$ 678,771,580**

Board of Water and Light - City of Lansing, Michigan

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30	
	2004	2003
Operating Revenues (Note 1)		
Water	$ 23,066,577	$ 22,347,385
Electric	172,154,018	176,791,144
Steam	21,513,873	23,319,056
Total operating revenues	216,734,468	222,457,585
Operating Expenses		
Production:		
Fuel, purchased power, and other operating expenses	106,196,537	111,636,280
Maintenance	19,837,258	18,282,173
Transmission and distribution:		
Operating expenses	7,445,011	7,242,102
Maintenance	7,677,096	7,555,454
Administrative and general	40,458,897	29,836,550
Depreciation and impairment (Note 1)	29,245,316	24,117,090
Total operating expenses	210,860,115	198,669,649
Operating Income	5,874,353	23,787,936
Nonoperating Income (Expense)		
Investment income	209,348	3,565,901
Other income	8,752,650	3,931,814
System capacity fee	9,331,480	11,274,028
Bonded debt interest expense	(9,665,402)	(10,140,516)
Amortization - Central utilities complex	(3,550,000)	(5,160,000)
Payment in lieu of taxes (Note 7)	(8,526,209)	(8,728,280)
Other interest expense	(109,621)	(117,777)
Total nonoperating expense, net	(3,557,754)	(5,374,830)
Income Before Extraordinary Item and Capital Contributions	2,316,599	18,413,106
Extraordinary Item		
Change in accounting principles (Note 6)	-	15,257,495
Income Before Capital Contributions	2,316,599	33,670,601
Capital contributions (Note 1)	3,183,085	5,492,448
Change in Net Assets	5,499,684	39,163,049
Net Assets - Beginning of year - As restated (Note 16)	463,071,744	423,908,695
Net Assets - End of year	**$ 468,571,428**	**$ 463,071,744**

Statement of Cash Flows

	Year Ended June 30	
	2004	2003
Cash Flows From Operating Activities		
Cash from customers:		
Water	$ 23,621,055	$ 23,064,208
Electric	175,544,069	177,343,968
Steam	21,948,913	23,634,975
Total	221,114,037	224,043,151
Cash paid to suppliers:		
Suppliers of coal, freight, and purchased power	(75,238,072)	(86,118,498)
Other suppliers	(57,981,769)	(46,453,488)
Total	(133,219,841)	(132,571,986)
Cash paid to employees	(42,081,355)	(41,028,718)
Payment in lieu of taxes (Note 7)	(8,526,209)	(8,728,280)
Net cash provided by operating activities	37,286,632	41,714,167
Cash Flows From Capital and Related Financing Activities		
Proceeds from new borrowings	30,716,977	44,399,502
Contributions in aid of construction - Water	3,183,085	5,492,448
Planned, bonded, and annual construction	(42,459,327)	(36,128,277)
Principal payments on debt	(35,907,498)	(27,476,193)
System capacity fees	8,553,405	10,202,103
Interest on debt	(9,894,841)	(9,973,660)
Net cash used in capital and related financing activities	(45,808,199)	(13,484,077)
Cash Flows From Noncapital Financing Activities		
Customer deposits	12,969	8,185
Interest on customer deposits	(17,012)	(17,355)
Pension fund debt payments	(1,683,784)	(142,078)
Interest on pension fund debt	(92,608)	(100,422)
Other	7,640,753	2,781,606
Net cash provided by noncapital financing activities	5,860,318	2,529,936
Cash Flows From Investing Activities		
Proceeds from the sale and maturity of investments	18,062,084	10,360,131
Interest received	2,048	2,063,781
Purchase of investments	(40,617)	(35,401,029)
Net cash provided by (used in) investing activities	18,023,515	(22,977,117)

	Year Ended June 30	
	2004	2003
Net Increase in Cash and Cash Equivalents	$ 15,362,266	$ 7,782,909
Cash and Cash Equivalents - Beginning of year	43,777,513	35,994,604
Cash and Cash Equivalents - End of year	**$ 59,139,779**	**$ 43,777,513**

Reconciliation of operating income to net cash provided by operating activities:

	Year Ended June 30	
	2004	2003
Operating income	$ 5,874,353	$ 23,787,936
Adjustments to reconcile operating income to net cash provided by operating activities		
Payment in lieu of taxes (Note 7)	(8,526,209)	(8,728,280)
Depreciation	29,245,316	24,117,090
Sewerage collection fees	1,111,896	1,150,208
(Increase) decrease in assets:		
Accounts receivable (Note 1)	2,794,002	(298,335)
Unbilled accounts receivable (Note 1)	473,670	733,693
Inventories	2,211,409	597,097
Other	(176,802)	(1,145,436)
Increase (decrease) in liabilities:		
Accounts payable and other accrued expenses	2,927,994	1,690,268
Other and deferred costs	1,351,003	(190,074)
Total adjustments	31,412,279	17,926,231
Net cash provided by operating activities	**$ 37,286,632**	**$ 41,714,167**

Significant Non-cash Activity: The BWL discontinued the application of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation* for certain items effective July 1, 2002. This resulted in non-cash activity totaling $15,257,495 for the year ended June 30, 2003, and is disclosed in Note 6.

Note 1 - Significant Accounting Policies

Reporting Entity - The Board of Water and Light (BWL), a related organization of the City of Lansing, Michigan (the City), is an administrative board established by the City Charter. The City Charter grants the BWL full and exclusive management of the water, heat, steam, and electric services of the City. The commissioners of the governing board are appointed by the Mayor with approval of the City Council. The BWL provides electric, water, and steam services to the City and surrounding townships. The governing board (Board of Commissioners) has the exclusive authority to set rates for the services provided. The financial statements include the financial activities of the water, electric, and steam operations of the BWL. The BWL is exempt from taxes on income because it is a municipal entity.

Basis of Accounting - The BWL utilizes the accrual basis of accounting. In addition, the BWL follows the accounting and reporting requirements of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which requires that the effects of the ratemaking process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of net income in order to follow the principle of matching costs and revenues. Accordingly, the BWL records various regulatory assets and liabilities to reflect the regulator's actions (Note 6). Management believes that the BWL meets the criteria for continued application of SFAS No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment.

On July 1, 1994, BWL adopted Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*. Under this statement, the BWL elected to follow all SFAS statements issued after November 30, 1989, that do not conflict with GASB Statements.

System of Accounts - The BWL's accounts are maintained substantially in accordance with the Uniform Systems of Accounts of the Federal Energy Regulatory Commission for its electric and steam systems and in accordance with the Uniform Systems of Accounts of the National Association of Regulatory Utility Commissioners for the water system.

Note 1 - Significant Accounting Policies (Continued)

Cash and Cash Equivalents - The BWL considers demand deposits and current restricted funds, which consist of cash and highly-liquid investments with an original maturity of 90 days or less, as cash and cash equivalents for financial statement purposes.

Investments - The BWL has established special purpose funds designated to meet anticipated operating requirements. These funds consist principally of certificates of deposit and United States Government securities and are segregated as follows:

	Carrying Value at June 30	
	2004	2003
Designated Purpose		
Coal inventory fluctuation	$ 3,590,838	$ 3,586,383
Litigation, environmental, and uninsured losses	14,803,531	14,986,991
Future water facilities	2,926,060	2,977,043
Total	$ 21,320,429	$ 21,550,417

Accounts Receivable - Accounts receivable are stated at net invoice amounts. A general valuation allowance is established based on an analysis of the aged receivables and historical loss experience. All amounts deemed to be uncollectible are charged to expense in the period that determination is made. Accounts receivable are not deemed uncollectible until they are approximately 270 days past due and have remained completely unpaid throughout the BWL's collection policy. The components of accounts receivable for 2004 and 2003 are as follows:

	2004	2003
Customer receivables	$ 10,833,122	$ 11,130,639
Sewerage collections	1,727,222	1,881,754
Insurance recoveries	-	2,691,416
Combined sewer overflow - City of Lansing	1,142,318	-
MPPA receivable	3,076,176	3,917,027
Miscellaneous	2,016,802	1,818,806
Less: Allowance for doubtful accounts	(900,000)	(750,000)
Total	$ 17,895,640	$ 20,689,642

Note 1 - Significant Accounting Policies (Continued)

Inventories are stated at weighted average cost and consist of the following at June 30:

	2004	2003
Coal	$ 3,593,205	$ 6,713,870
Materials and supplies	7,228,074	6,318,818
Total	$ 10,821,279	$ 13,032,688

Utility plant is stated on the basis of cost, which includes expenditures for new facilities and those which extend the useful life of existing facilities and equipment. Expenditures for normal repairs and maintenance are charged to maintenance expense as incurred.

Depreciation of utility plant is computed using the straight-line method based on estimated useful lives, except for depreciation related to the central utilities complex, which is computed in accordance with SFAS No. 71. The resulting provisions for depreciation in 2004 and 2003, expressed as a percentage of the average depreciable cost of the related assets, are as follows:

	Average Rate	
	2004	2003
Classification of utility plant:		
Water	1.9 %	1.9 %
Electric	3.8	3.1
Steam	3.8	3.8
Common facilities	5.0	4.8
Central utilities complex	4.7	6.7

When units of property are retired, their costs are removed from utility plant and charged to accumulated depreciation.

Accrued Compensated Absences - BWL records a liability for estimated compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the BWL and its employees. This liability is accrued as employees earn the rights to such benefits. The BWL estimates the total current and noncurrent portions of the liability to be $10,517,093 and $9,660,390 as of June 30, 2004 and 2003, respectively.

Note 1 - Significant Accounting Policies (Continued)

Capital Contributions - Capital contributions represent nonrefundable amounts received from customers for construction of utility plant. In accordance with GASB Statement No. 33, contributions for water are recorded as net assets invested in capital assets, net of related debt.

Electric and steam contributions are credited against the related assets and will offset the depreciation of the related assets over the estimated useful life. This treatment is consistent with the BWL's ratemaking policy and is thus permitted under SFAS No. 71.

Net Assets - Equity is classified as net assets and displayed in three components:

- Invested in Capital Assets, net of related debt - consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds that are attributable to the acquisition, construction, or improvement of those assets.

- Restricted for Debt Service - Consists of net assets with constraints placed on their use by revenue bond resolution.

- Unrestricted - All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Unbilled Accounts Receivable and Revenue - Unbilled accounts receivable at June 30, 2004, represents the estimated amount of accounts receivable for services that have not been billed as of the balance sheet date. The amounts are a result of a timing difference between the end of the financial statement cycle (month end) and the billing cycle (various dates within the month for each billing period). Accordingly, the current year revenue from customers whose billing period ends after June 30 for services rendered prior to June 30 will be recognized in the current period.

The water, electric, and steam operations of the BWL bill each other for services provided, and these services are reported as revenue to the generating operation and expense to the consuming operation. Such internal billings aggregated $5,834,096 and $6,329,407 in 2004 and 2003, respectively, and are not eliminated in the statements of income.

Note 1 - Significant Accounting Policies (Continued)

Emissions Allowance - The Environmental Protection Agency has granted emission allowances to the BWL related to the emission of certain pollutants. No amounts are recorded at the date of the grant. The BWL estimates the allowances needed for future years. As appropriate, the BWL may purchase additional allowances or sell the estimated future excess allowances. The purchase and sale of allowances by emission type is accounted for separately and is not offset against transactions involving allowances of different emission types. Purchased allowances net of proceeds from the sale of related allowances are recorded as an asset and will be expensed during the applicable period. Proceeds from the sale of allowances are recognized as income at the time of sale.

The BWL recognized a gain of approximately $5.8 million and $2.6 million as of June 30, 2004 and 2003, respectively, from the sale of allowances and has recorded an intangible asset of approximately $1.5 million and $1.1 million as of June 30, 2004 and 2003, respectively, for purchased allowances related to future periods.

Significant Customers - The BWL has one customer which accounts for approximately 17 and 16 percent of the BWL's total revenue for the years ended June 30, 2004 and 2003, respectively.

Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Note 2 - Rate Matters

Rates charged to customers are established solely by the governing board. The BWL has agreed to charge rates sufficient to meet certain requirements of the bond resolutions for the outstanding revenue bonds.

Note 3 - Construction-in-Progress

Construction-in-progress consists of projects for expansion or additions to utility plant. The estimated additional cost to complete these projects, based on the BWL capital budget, approximates $29,856,000 at June 30, 2004, including commitments on existing construction contracts approximating $4,102,000. These projects will be funded through operational cash flow, including the project funds reported as other assets.

Note 4 - Restricted Assets

The restricted assets are required under the 1989A, 1989B, 1994A, 1994B, 1999A, 1999B, 2001A, 2002A, 2002B, and 2003A Revenue Bond resolutions and the related Nonarbitrage and Tax Compliance Certificates. These assets, which consist of cash, certificates of deposit, commercial paper, and United States Government securities, are segregated into the following funds:

	Required at June 30,	Carrying Value at June 30	
	2004	2004	2003
Current:			
Operations and Maintenance Fund	$ 20,938,545	$ 44,432,176	$ 27,495,032
Bond and Interest Redemption Fund	12,830,580	14,707,603	16,282,481
Total current	33,769,125	59,139,779	43,777,513
Noncurrent:			
2001A Construction Fund	1,618,627	1,618,627	1,636,067
2002A & B Construction Fund	1,076,508	1,076,508	18,973,347
2003A Construction Fund	4,896	4,896	-
Bond Reserve Fund	7,866,138	9,723,543	9,725,240
Rebate Fund	418,251	496,743	377,142
Total noncurrent	10,984,420	12,920,317	30,711,796
Total	$ 44,753,545	$ 72,060,096	$ 74,489,309

Note 4 - Restricted Assets (Continued)

The restrictions of the various funds are as follows:

- **Operations and Maintenance Fund** - By the end of each month, this fund shall include sufficient funds to provide for payment of the succeeding month's expenses.
- **Bond and Interest Redemption Fund** - Restricted for payment of the current portion of bond principal and interest and the remaining capitalized interest on the 1989A, 1989B, 1994A, 1994B, 1999A, 1999B, 2001A, 2002A, 2002B, and 2003A Revenue Bonds.
- **2001A Construction Fund** - Restricted for payment of costs of the 2001A bonded projects and costs of issuance of the 2001A Revenue Bonds.
- **2002A and 2002B Construction Fund** - Restricted for payment of costs of the 2002A and 2002B bonded projects and costs of issuance of the 2002A and 2002B Revenue Bonds.
- **2003A Construction Fund** - Restricted for payment of costs of the 2003A bonded projects and costs of issuance of the 2003A Revenue Bonds.
- **Bond Reserve Fund** - Shall include sufficient funds to cover the maximum annual principal and interest requirements for the outstanding 1989A, 1989B, 1994A, 1994B, 1999A, 2001A, and the uninsured portion of the 2002A, 2002B, and 2003A Revenue Bonds.
- **Rebate Fund** - Shall include sufficient funds to enable the BWL to rebate arbitrage investment earnings to the federal government in accordance with Section 148(f)(2) of the Internal Revenue Code (IRC) of 1986, as amended (Note 12).

Note 5 - Long-Term Debt

Long-term debt as of June 30 consists of the following:

	2004	2003
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 2003A, due serially through July 1, 2026, plus interest at rates ranging from 2.50% to 5.00%	$ 29,830,000	$ -
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 2002A, due serially through July 1, 2018, plus interest at rates ranging from 3.50% to 5.00%	23,730,000	24,130,000
Water Supply, Steam, and Electric Utility System Revenue Refunding Bonds, Series 2002B, due serially through July 1, 2013, plus interest at rates ranging from 3.00% to 3.75%	18,750,000	18,920,000
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 2001A, due serially through July 1, 2015, plus interest at rates ranging from 3.50% to 5.00%. Bonds were defeased during the year ended June 30, 2004	-	11,650,000
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 1999B, due serially through July 1, 2016, plus interest at rates ranging from 7.10% to 7.70%	70,919,000	74,229,000
Water Supply, Steam, and Electric Utility System Revenue Bonds, Series 1999A, due serially through July 1, 2014, plus interest at rates ranging from 4.10% to 5.50%	27,120,000	44,515,000
Water Supply and Electric Utility System Revenue Bonds, Series 1994A, due serially through July 1, 2004, plus interest at 6.20%	675,000	915,000
Water Supply and Electric Utility System Revenue Bonds, Series 1994B, due serially through July 1, 2008, plus interest at rates ranging from 4.60% to 5.00%	971,000	1,971,000
Water Supply and Electric Utility System Revenue Bonds, Series 1989A, which mature serially through July 1, 2004, plus interest at rates ranging from 5.75% to 6.80%	500,000	1,750,000
Water Supply and Electric Utility System Revenue Bonds, Series 1989B, which mature serially through July 1, 2004, plus interest at rates ranging from 6.70% to an imputed rate of 6.75%. These bonds are redeemable on demand by bondholders	398,000	372,432

Note 5 - Long-Term Debt (Continued)

	2004	2003
Promissory Notes, due to the City of Lansing in semi-annual installments through September 20, 2024, plus interest at 2.50%	$ 2,041,642	$ -
Amount due Plan for Employees' Pension in annual installments of $242,500, including interest at 5.50% through June 30, 2012. Loan was paid in full during the year ended June 30, 2004	-	1,683,784
Promissory Note, due in monthly installments of $21,268, including interest at 5.79%. Loan was paid in full during the year ended June 30, 2004	-	266,474
Promissory Note, due in monthly installments of $9,492, including interest at 4.344%, with final payment December 30, 2008	444,028	-
Promissory Note, due in monthly installments of $3,923, including interest at 4.944%, with final payment October 2006	103,551	144,227
Promissory Note, due in monthly installments of $15,833, including interest at 4.889%, with final payment September 2008	727,797	-
Township contract water service obligation	463,688	546,549
Total	176,673,706	181,093,466
Less current portion	8,259,708	8,902,675
Plus unamortized premium	1,029,784	1,103,340
Deferred amount on refunding of bonds	(1,942,945)	-
Total long-term portion	$ 167,500,837	$ 173,294,131

The fair value of the long-term debt based on the quoted market prices for similar issues for debt of the same remaining maturities is estimated to be $191,272,105 and $208,410,086 at June 30, 2004 and 2003, respectively.

The unamortized premium and deferral on refunded bonds is being amortized over the life of the bonds, using the effective-interest method.

Note 5 - Long-Term Debt (Continued)

Aggregate annual principal payments applicable to long-term debt are as follows:

	Principal	Interest	Total
2005	$ 8,259,708	$ 10,085,604	$ 18,345,312
2006	8,686,784	9,380,263	18,067,047
2007	9,032,190	8,903,793	17,935,983
2008	9,497,073	8,400,200	17,897,273
2009	9,816,860	7,860,378	17,677,238
2010 - 2014	57,666,318	29,855,797	87,522,115
2015 - 2019	54,738,068	11,314,368	66,052,436
2020 - 2024	11,192,805	3,232,730	14,425,535
2025 - 2027	7,783,900	585,215	8,369,115
Total	$ 176,673,706	$ 89,618,348	$ 266,292,054

Resolutions of the 1989A, 1989B, 1994A, 1994B, 1999A, 2001A bonds and the uninsured portion of the 2002A, 2002B, and 2003A bonds require the BWL to establish a reserve account equal to the highest annual principal and interest requirements of such issues. As of June 30, 2004, the balance of this reserve account was $9,723,543 (Note 4) satisfying these requirements. The reserve requirements for the 1999B bonds and a portion of the 2002B bonds are satisfied by the purchase of a debt service reserve fund surety bond. In order to assure the availability of funds necessary to redeem the 1989 Series B bonds, which are redeemable on demand by bondholders, the BWL maintains a $2,000,000 long-term unsecured line of credit which expires upon payment of the 1989B bonds. Subsequent to year end, the bonds were paid in full and the line of credit expired. At June 30, 2004 and 2003, there were no outstanding borrowings under this line of credit.

All Water Supply and Electric Utility System Revenue Bonds were issued by authority of the BWL. Except for the Series 1999B Subordinate Lien Revenue Bonds, these bonds were issued on a parity basis and are payable solely from the net revenue of combined water, electric, and steam operations of the BWL.

Note 5 - Long-Term Debt (Continued)

During the fiscal year ended June 30, 2004, the BWL issued $29,830,000 of Water Supply, Steam, and Electric Utility System Revenue Refunding Bonds Series 2003A with an average interest rate of 4 percent; the proceeds were used to refund $11,435,000 of Series 2001A and $15,575,000 of Series 1999A Water Supply, Steam, and Electric Utility System Revenue bonds with average interest rates of 4 and 5 percent, respectively. There is an economic loss $1,985,660 to BWL. The deferred loss on refunding is the difference between the reacquisition price of $29,112,202 and the net carrying amount of the old bonds of $27,010,000. The net deferred amount on refunding of $2,102,202 will be amortized using the effective-interest method over the life of the old bonds. The proceeds of the new bonds were placed in an escrow deposit fund to provide for all future debt service payments on the old bonds. Accordingly, the escrow deposit fund assets and the liability for the defeased bonds are not included in the financial statements.

The BWL may redeem certain outstanding Water Supply and Electric Utility System Revenue Bonds prior to maturity. The Series 2003A bonds maturing in the years 2004 to 2013, inclusive, shall not be subject to redemption prior to maturity. Series 2003A bonds due on or after July 1, 2014 to 2026, inclusive, shall be subject to redemption prior to maturity, at the option of BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2013, at par plus accrued interest to the date fixed for redemption.

The Series 2002A bonds maturing in the years 2003 to 2012, inclusive, and the Series 2002B bonds shall not be subject to redemption prior to maturity. Series 2002A bonds due on or after July 1, 2013, shall be subject to redemption prior to maturity, at the option of BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2012, at par plus accrued interest to the date fixed for redemption.

The Series 1999B bonds maturing in the years 2002 to 2009, inclusive, shall not be subject to redemption prior to maturity. Series 1999B bonds due on or after July 1, 2010, shall be subject to redemption prior to maturity, at the option of BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2009, at par plus accrued interest to the date fixed for redemption. In addition, there was a special optional redemption on January 1, 2003, for all series 1999B bonds from unexpended series 1999B bond proceeds on hand as of November 1, 2002, if any, at a price of 101 percent of their par value plus accrued interest, if any, to the date of redemption.

Note 5 - Long-Term Debt (Continued)

The Series 1999A Bonds maturing in the years 2001 to 2009, inclusive, shall not be subject to redemption prior to maturity. Series 1999A bonds due on or after July 1, 2010, shall be subject to redemption prior to maturity, at the option of BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 2009, at par plus accrued interest to the date fixed for redemption. During the year ended June 30, 2004, Series 1999A bonds in the amount of $15,575,000 were defeased and this portion of the bond payable was removed from the BWL.

The Series 1994A bonds maturing in the years 2000 to 2004, inclusive, shall not be subject to redemption prior to maturity. Series 1994A bonds due on or after July 1, 2005, were subject to redemption prior to maturity, at the option of BWL. During the fiscal year ended June 30, 2003, the bonds due after July 1, 2005, were redeemed with the issuance of the 2002B Revenue Refunding Bonds. The Series 1994B bonds are non-callable.

Series 1989A bonds maturing in the years 1998 to 2004, inclusive, shall be subject to redemption prior to maturity, at the option of the BWL, in such order of maturity as the BWL may determine, and by lot within any maturity, in whole or in part, on any date on or after July 1, 1997, at par plus accrued interest to the date fixed for redemption, plus a premium expressed as a percentage of principal amount, as follows:

- 1 percent of the principal amount of each bond or portion thereof called for redemption on or after July 1, 1999, but prior to July 1, 2001.
- No premium shall be paid on bonds or portions thereof called for redemption on or after July 1, 2001.

The Series 1989B bond issue is sub-divided into Current Interest Bonds and Capital Appreciation Bonds. The Current Interest Bonds matured on July 1, 1999. The currently remaining Capital Appreciation Bonds are subject to redemption at the option of the BWL, in whole or in part, by lot, at 100 percent of the accreted value.

Note 5 - Long-Term Debt (Continued)

The long-term debt activity for the year ended June 30, 2004, is as follows:

	Compensated Absences	Revenue Bonds	Other Notes	Total
Beginning balance	$ 9,660,390	$ 179,632,526	$2,564,280	$ 191,857,196
Additions	856,703	27,753,365	3,401,656	32,011,724
Reductions	-	(35,406,052)	(2,185,230)	(37,591,282)
Ending balance	$ 10,517,093	$ 171,979,839	$3,780,706	$ 186,277,638
Due within one year	$ 3,278,936	$ 8,064,590	$ 195,118	$ 11,538,644

Note 6 - Deferred Costs/Credits Recoverable in Future Years

During the year ended June 30, 2002, the BWL deferred $2,453,371 in interest expense incurred on certain bonded debt used to fund the construction of a central utilities complex. Such amounts were capitalized in accordance with the provisions of SFAS No. 71 since these costs were not included in the establishment of the BWL's rate base for the year ended June 30, 2002. Additionally, the BWL deferred interest earnings totaling $275,992 during the year ended June 30, 2002, resulting from the temporary investment of the bond proceeds used to fund the central utilities complex. Upon completion of the facility during the year ended June 30, 2003, these deferrals were included in the capitalized cost of the facility.

As a result of changes in the competitive and regulatory environments in which it operates, the BWL determined that the application of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulations* is no longer appropriate for certain items effective for fiscal year beginning July 1, 2002. These items were compensated absences and workers' compensation claims not recorded as expenditures until paid, and proceeds of the Belle River Arbitration Settlement recognized as received in the form of reductions to power purchases in the year the reduction occurs. Accordingly, the financial statements of the BWL for the year ended June 30, 2003, reflect a gain of approximately $15.3 million arising from amounts recognized at June 30, 2002, and the elimination of the corresponding regulatory assets and liabilities.

During the year ended June 30, 2004, the Board of Commissioners approved the use of SFAS No. 71 in accounting for the depreciation of the central utilities complex, which is a separate operating unit of the BWL, and for electric and steam capital contributions.

Note 6 - Deferred Costs/Credits Recoverable in Future Years (Continued)

Effective for the year ended June 30, 2004, SFAS No. 71 was used in accounting for expenses to be incurred and the estimated liability for environmental remediation of a landfill site operated by the BWL. A regulatory asset of $4,623,000 was created as a result.

As a result of its Belle River Fuel Arbitration settlement, Michigan Public Power Agency (MPPA), a provider of energy to the BWL (Note 10), has received a refund resulting from overcharges of fuel cost charges in prior years. The BWL's share of the proceeds of this settlement are held in trust for the benefit of the BWL and will be applied as reductions to future power purchase billings at the direction of the BWL and with the approval of the Board of Commissioners of MPPA. Accordingly, at June 30, 2004 and 2003, the BWL recorded a long-term receivable of $17,773,665 and $17,566,365, respectively, relating to such assets held in trust.

Note 7 - Transactions With the City of Lansing, Michigan

Operations - The BWL recognized revenue of $6,237,795 and $6,336,449 in 2004 and 2003, respectively, for water, electric, and steam services provided to the City. The BWL incurred expenses for sewerage services purchased from the City of $283,207 and $299,650 in 2004 and 2003, respectively.

Additionally, the BWL bills and collects sewerage fees for the City. In connection with these services, the BWL received sewerage collection fees of $1,111,897 and $1,150,208 in 2004 and 2003, respectively, included in other income.

Payment in Lieu of Taxes - Effective July 1, 1992, the BWL entered into an agreement with the City to provide an annual payment of a return on equity in accordance with a formula based on net billed retail sales from its water, steam heat, and electric utilities for the preceding 12 month period ending May 31 of each year. Effective March 1, 2002 and ending June 30, 2012, the formula to calculate the amount owed to the City for payment in lieu of taxes will also include revenue generated from the BWL's sales for resale on its water, steam heat, and electric utilities for the preceding 12 month period ending May 31 of each year. Subject to the provisions of Act 94 Public Acts of 1933, as amended, and the BWL's various bond covenants, this amount is payable to the City no later than June 30 of each year. Under terms of this agreement, the BWL paid to the City $8,526,209 in 2004, and $8,728,280 in 2003, of operational cash flow in excess of debt service requirements.

Note 8 - Retirement Plans

The BWL has two retirement plans. The BWL administers a tax qualified, single-employer, noncontributory, defined benefit public employee retirement pension plan (the "Defined Benefit Plan"), and the BWL has a tax qualified, single-employer, noncontributory, defined contribution public employee retirement pension plan (the "Defined Contribution Plan").

Defined Benefit Plan

The defined benefit plan was established by the BWL in 1939 under Section 5-203 of the City Charter and has been revised several times, with the latest revision taking effect on November 19, 2002.

The Defined Benefit Plan, by resolution of the Board of Commissioners, was closed to employees hired subsequent to December 31, 1996, and a Defined Contribution Plan was established for employees hired after December 31, 1996. Effective December 1, 1997, all active participants in the Defined Benefit Plan were required to make an irrevocable choice to either remain in the Defined Benefit Plan or move to the newly established Defined Contribution Plan. Those participants who elected to move to the Defined Contribution Plan received lump sum distributions from the Defined Benefit Plan, which were rolled into their accounts in the new Defined Contribution Plan. Of the 760 current employees that were required to make this election, 602 elected to convert their retirement benefits to the newly established Defined Contribution Plan.

The Plan for Employees' Pensions of the Board of Water and Light - City of Lansing, Michigan - Defined Benefit Plan issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Board of Water and Light, Senior Vice President of Finance and Administration, Post Office Box 13007, Lansing, Michigan 48901-3007.

A participant's interest is fully vested when the participant has been credited with seven years of vesting service. The Defined Benefit Plan provides for an annual benefit upon normal retirement equal to the total number of years of credited service multiplied by 1.8 percent of the highest annual pay during the last 10 years of service, paid in equal monthly installments.

Note 8 - Retirement Plans (Continued)

Effective July 1, 1999, the Defined Benefit Plan was amended to include a medical-benefit component, in addition to the normal retirement benefits, to fund a portion of the post-retirement obligations for certain retirees and their beneficiaries. The funding of the medical benefit component is limited to the amount of excess pension plan assets available for transfer, as determined by the actuary. For the year ended June 30, 2003, these amounts totaled $0. Therefore, no medical benefits were paid by the Defined Benefit Plan during the year ending June 30, 2003. During the year ended June 30, 2004, medical benefits paid by the Defined Benefit Plan totaled $4,813,944.

Basis of Accounting - The Defined Benefit Plan's financial statements are prepared using the accrual basis of accounting. Benefits are recognized when due and payable in accordance with the terms of the Defined Benefit Plan.

Investment Valuation and Income Recognition - The Defined Benefit Plan investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price. Investments that do not have an established market are reported at estimated fair values.

Funding Policy and Annual Pension Cost - The BWL's funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are designed to accumulate sufficient assets to pay benefits when due. The normal cost and amortization payment for the years ended June 30, 2004, 2003, and 2002, were determined using an attained age projected unit credit actuarial funding method. No transition adjustments were required upon implementation of Governmental Accounting Standards Board No. 27, *Accounting for Pensions by State and Local Government Employers*. Overfunded actuarial accrued liabilities were amortized as a level dollar reduction of contributions over a period of 15 years in 2004, 2003, and 2002.

The annual pension cost was determined as part of an actuarial valuation of the Defined Benefit Plan as of February 29, 2004, February 28, 2003, and February 28, 2002. Significant actuarial assumptions used in determining the annual pension cost include (a) rate of return on the investment of present and future assets of 7.5 percent in 2004, 2003, and 2002, compounded annually, (b) projected salary increases of 5.0 percent in 2004, 2003, and 2002, compounded annually, attributable to inflation, (c) additional projected salary increases ranging from 0.0 to 11.0 percent in 2004, 2003, and 2002, depending on age, attributable to seniority/merit, and (d) the assumption that benefits will not increase after retirement.

Note 8 - Retirement Plans (Continued)

Employer contributions were made in accordance with contribution requirements determined by an actuarial valuation of the Defined Benefit Plan and consisted of the following:

	2004	2003	2002
Normal cost	$ 762,292	$ 823,367	$ 929,313
Amortization of the overfunded actuarial accrued liability	(4,859,003)	(5,420,082)	(5,063,690)
Employer contributions	None	None	None

Schedule of Funding Progress (Unaudited - Required Information) (in thousands)

Valuation Date	Actuarial Asset Values	AAL	UAAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
February 28, 2002	$ 143,158	$ 91,726	$ (51,432)	156	$ 5,253	(979.1)
February 28, 2003	137,123	91,015	(46,108)	151	4,922	(936.8)
February 29, 2004	136,749	89,612	(47,137)	153	4,476	(1,053.1)

AAL: Actuarial Accrued Liability (Projected Unit Credit Accrued Liability).

UAAL: Unfunded Actuarial Accrued Liability, negative UAAL indicates a funding excess.

Three-Year Trend Information - Assets available at market; actuarial accrued liability - projected unit cost method (AAL); unfunded actuarial accrued liability (UAAL) and negative UAAL indicates a funding excess.

(Dollar amounts in thousands)

Fiscal Year Ended	Assets Available	AAL	UAAL	Funded Ratio
June 30, 2002	$ 124,837	$ 91,726	$ (33,111)	136
June 30, 2003	126,359	91,015	(35,344)	139
June 30, 2004	126,728	89,612	(37,116)	141

Note 8 - Retirement Plans (Continued)

For the year ended June 30, 2003, there was an amount due to the Defined Benefit Plan from the BWL (Note 5) resulting from unfunded current service costs for the years 1968 through 1972. This amount was included in plan assets for actuarial valuation purposes. During the year ended June 30, 2004, the BWL paid the amount due in full.

Defined Contribution Plan

The Defined Contribution Plan was established by the BWL in 1997 under Section 5-203 of the City Charter. The Defined Contribution Plan covers substantially all full-time employees hired after December 31, 1996. In addition, 602 employees hired before January 1, 1997, elected to convert their retirement benefits from the Defined Benefit Plan effective December 1997.

The Plan for Employees' Pensions of the Board of Water and Light - City of Lansing, Michigan - Defined Contribution Plan issues a publicly available financial report. That report may be obtained by writing to the Board of Water and Light, Senior Vice President of Finance and Administration, Post Office Box 13007, Lansing, Michigan 48901-3007.

The Defined Contribution Plan operates as a money purchase pension plan and meets the requirements of Sections 401(a) and 501(a) of the IRC of 1986, as amended from time to time.

For employees hired before January 1, 1997, the BWL is required to contribute 15.0 percent of the employees' compensation. For employees hired after January 1, 1997, the BWL is required to contribute 8.1 percent of the employees' compensation. In addition, the BWL is required to contribute 3.0 percent of the employees' compensation for all employees who are not eligible to receive overtime pay and 0.5 percent of the employees' compensation for all non-bargaining employees.

The BWL contributions are recognized in the period that the contributions are due.

Note 8 - Retirement Plans (Continued)

Other Postretirement Benefits

In addition to providing pension benefits, the BWL provides certain hospitalization, dental, and life insurance benefits for retired employees in accordance with Section 5-203 of the City Charter. Substantially all of the BWL's employees may become eligible for health care benefits and life insurance benefits if they reach normal retirement age while working for the BWL. Fifty percent of the cost of life insurance benefits will be paid by bargaining unit employees. The hospitalization and dental benefits are provided through an insurance company whose premiums are based on the benefits paid during the year. For the year ended June 30, 2004, the total cost of providing such benefits was $5,876,481, of which $4,813,944 was funded by the Defined Benefit Plan of the BWL, and the remainder was funded by BWL. For the year ended June 30, 2003, the total cost of providing such benefits was $5,166,126 which was entirely funded by the BWL. There were 618 participants eligible to receive benefits at June 30, 2004, and 604 participants eligible at June 30, 2003.

In October 1999, the BWL formed a Voluntary Employee Benefit Administration (VEBA) trust for the purpose of accumulating assets sufficient to fund retiree health care insurance costs in future years. During the years ended June 30, 2004 and 2003, the BWL contributed $6,704,484 and $1,148,180, respectively, to the VEBA trust.

The BWL offers its employees a deferred compensation plan, created in accordance with IRC 457, that is administered by a Trustee, the ICMA Retirement Corporation. The BWL does not contribute to this plan.

Note 9 - Commitments and Contingencies

At June 30, 2004, the BWL has unused letters of credit in the amounts of $817,220 and $1,000,000, issued to the Michigan Department of Natural Resources. The letters of credit were issued to satisfy requirements of the Michigan Department of Natural Resources to provide financial assurance to the State of Michigan for the cost of closure and post-closure monitoring and maintenance of a landfill site operated by the BWL.

Note 9 - Commitments and Contingencies (Continued)

Through monitoring tests performed on the landfill site operated by the BWL, it has been discovered that the site is contaminating the groundwater. The contamination does not pose a significant health risk, but does lower the quality of the groundwater. The BWL is currently in the process of applying for approval from the State of Michigan to remediate the site. The BWL has estimated the total cost for remediation of the landfill to be $4,623,000 and has recorded the liability for the year ended June 30, 2004. In accordance with SFAS No. 71 (Note 1), the BWL recorded a corresponding regulatory asset (Note 6).

The BWL has announced a program to upgrade existing lead pipes throughout the BWL service area over the course of approximately 10 years at a cost of approximately $30,000,000.

The BWL is subject to various laws and regulations with respect to environmental matters such as air and water quality, soil contamination, solid waste disposal, handling of hazardous materials, and other similar matters. Compliance with these various laws and regulations could result in substantial expenditures. The BWL has established a Designated Purpose Fund (Note 1) of which one of the purposes of the fund is to meet extraordinary expenditures resulting from responsibilities under environmental laws and regulations. Management believes that all known or expected responsibilities to these various laws and regulations by the BWL will be sufficiently covered by the Designated Purpose Fund and the environmental remediation liability.

Certain segments of the BWL's employees are covered by a collective bargaining agreement, which expired in October 2003. Management of the BWL is currently involved in negotiations on a new collective bargaining agreement. Employees covered under this agreement represent 60 percent of BWL's active employees.

The BWL is involved in various other legal actions, which have arisen in the normal course of business. Such actions are usually brought for claims in excess of possible settlement or awards, if any, that may result. After taking into consideration legal counsel's evaluation of pending actions, management is of the opinion that the outcome thereof will not have a material effect on the financial position of the BWL.

During the year ended June 30, 2003, the BWL issued bonds to finance a capital project related to reducing NOx emissions in accordance with new regulations. As of June 30, 2004, the BWL had remaining commitments totaling approximately $2,501,000 relating to this project.

Note 9 - Commitments and Contingencies (Continued)

The BWL has entered into contracts to purchase coal totaling approximately $35,175,000 through December 31, 2006. In addition, the BWL has entered into contracts for the rail services related to shipping the coal. Commitments for future rail services to be purchased are approximately $88,200,000 through December 2008.

The BWL has entered into agreements for other operating activities totaling approximately $914,000 through December 31, 2006.

Note 10 - Power Supply Purchase

In 1983, the BWL entered into 35-year power supply and project support contracts with the Michigan Public Power Agency (MPPA), of which the BWL is a member. Under the agreement, the BWL will purchase 64.29 percent of the energy generated by MPPA's 37.22 percent ownership in Detroit Edison's Belle River Unit #1 (Belle River), which became operational in August 1984. These contracts require the BWL to annually pay debt service and fixed operating and maintenance costs on approximately 156 megawatts of capacity.

Under the terms of its contract, the BWL must make minimum annual payments equal to its share of debt service and its share of the fixed operating costs of Belle River. The estimated required payments presented below assume no early calls or refinancing of existing revenue bonds and a 3.0 percent annual inflation of fixed operating costs, which include expected major maintenance projects.

Note 10 - Power Supply Purchase (Continued)

Year	Debt Service	Estimated Fixed Operating	Total Required
2005	$ 17,674,594	$ 7,358,722	$ 25,033,316
2006	17,677,037	7,575,934	25,252,971
2007	17,674,811	7,803,520	25,478,331
2008	17,675,124	8,037,536	25,712,660
2009	17,677,776	8,278,623	25,956,399
2010	17,677,701	8,526,783	26,204,484
2011 - 2015	88,380,049	46,628,894	135,008,943
2016	17,677,540	10,181,607	27,859,147
Total	$ 212,114,632	$ 104,391,619	$ 316,506,251

In addition to the above required payments, the BWL must pay for fuel, other operating costs, and transmission costs related to any kilowatt hours (KWHs) purchased under these contracts.

The BWL recognized expenses for 2004 and 2003 of $38,364,377 and $37,239,127, respectively, to purchase power under the terms of this contract. The price of this power was calculated on a basis, as specified in the contracts, to enable MPPA to recover its production, transmission, and debt service costs.

In connection with the Belle River purchase, in December 2002, MPPA issued $280,180,000 principal amount of its Belle River Project Refunding Revenue Bonds, 2002 Series A, with rates ranging from 2.125 to 5.25 percent to advance refund $330,850,000 outstanding 1993A & B bonds.

Note 11 - Cash, Investments, and Fair Value Disclosures

The BWL maintains special purpose investment funds designated to meet specific operating requirements. The total of these special purpose funds is presented on the balance sheet as "investments". In addition, investments are separately held by several of the BWL's other designated funds.

Note 11 - Cash, Investments, and Fair Value Disclosures (Continued)

The captions on the June 30, 2004 and 2003 balance sheet related to cash and investments, are as follows:

	2004	2003
Investments	$ 21,320,429	$ 21,550,417
Current restricted cash and cash equivalents (including cash on hand of $747,216 in 2004 and $1,385,878 in 2003)	59,139,779	43,777,513
Noncurrent restricted assets	12,920,317	30,711,796
Total	$ 93,380,525	$ 96,039,726

Deposits - At June 30, 2004, the carrying amount of the BWL's bank deposits was $8,289,155 and the bank balance was $9,919,448. These amounts were $7,783,759 and $9,956,440 respectively, at June 30, 2004. Of the bank balance, $400,000 was covered by federal depository insurance and $9,519,448 and $9,556,440 respectively at June 30, 2004 and 2003, was uninsured and uncollateralized. Collateral is not required for deposits not covered by federal deposit insurance.

Investments - State statutes limit the BWL to investing in the obligations of the United States government and its agencies and commercial paper that is rated in the highest category by a nationally recognized rating agency.

The BWL's investments are categorized in the following table to give an indication of the level of custodial credit risk in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreement) and Reverse Repurchase Agreements*. Category 1 includes investments that are insured or registered or for which the securities are held by the BWL or its agent in the BWL's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the BWL's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the bank or by its trust department or agent but not in the BWL's name. (Categories do not include cash on hand or bank deposits as of June 30, 2004.)

Note 11 - Cash, Investments, and Fair Value Disclosures (Continued)

	Category			
June 30, 2004	1	2	3	Fair Value
United States Government securities	$ -	$ -	$ 74,950,573	$ 74,950,573
Commercial paper	-	9,393,334	-	9,393,334
Total	$ -	$ 9,393,334	$ 74,950,573	$ 84,343,907
June 30, 2003				
United States Government securities	$ -	$ -	$ 65,930,322	$ 65,930,322
Commercial paper	-	19,821,470	-	19,821,470
Total	$ -	$ 19,821,470	$ 65,930,322	$ 85,751,792

Due to higher cash flows at certain times of the year, the BWL's investment in uncollateralized deposits, unregistered securities, and repurchase agreements for which the underlying securities were held by the bank increased significantly at times. The maximum amount during the years ended June 30, 2004 and 2003, of uninsured and unregistered securities was $87,350,425 and $91,172,868 respectively. The maximum amount of uninsured and uncollateralized deposits was $49,890,727 and $12,315,107 for the years ended June 30, 2004 and 2003, respectively.

Management of the BWL believes that the BWL did not violate any legal or contractual provisions for deposits and investments during the year.

Note 12 - Estimated Liability for Excess Earning on Water Supply and Electric Utility System Revenue Bonds

In accordance with Section 148(f)(2) of the IRC of 1986, as amended, the BWL is required on each anniversary date (July 1) of the Water Supply, Electric Utility, and Steam Utility System Revenue Bonds, Series 1989A and B, Series 1994A and B, Series 1999A, Series 2001A, Series 2002A and B, and 2003A, to compute amounts representing the cumulative excess earnings on such bonds. That amount essentially represents a defined portion of any excess of interest earned on funds borrowed over the interest cost of the tax-exempt borrowings. Expense is charged (credited) annually in an amount equal to the estimated increase (decrease) in the cumulative excess earnings for the year. On every fifth anniversary date and upon final maturity of the bonds, the BWL is required to remit to the Internal Revenue Service the amount of any cumulative excess earnings computed on the date of such maturity plus an amount equal to estimated interest earned on previous years' segregated funds.

At June 30, 2004 and 2003, the estimated liability for excess earnings is $53,516 and $491,560 respectively. During the year ended June 30, 2004, the BWL made the required payment to the United States Treasury of $73,308, representing 90 percent of the arbitrage liability on series 1994A and 1994B bonds. In accordance with the requirements of the bond indenture, the BWL is required to set aside any current year additions to this estimated liability in a rebate fund within 60 days of the anniversary date of the bonds.

Note 13 - Enterprise Fund

The financial statements presented reflect only the financial statements of the Enterprise Fund of the BWL and do not include the assets, liabilities, equity, and operations of the Pension Funds and VEBA trust of the BWL. Management of the BWL has prepared these financial statements under such basis to facilitate the comparison of operating results with entities engaged in providing similar types of services.

Note 14 - Risk Management and Insurance

The BWL is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries (workers' compensation), as well as medical benefits provided to employees. The BWL has purchased commercial insurance for certain general liability, business auto, excess liability, property and boiler and machinery, public officials and employee liability claims, and specific excess workers' compensation claims, subject to policy terms, limits, limitations, and deductibles. The BWL is uninsured for other claims. Settled claims relating to the commercial insurance have not exceeded the amount of insurance coverage in any of the past three fiscal years.

Note 15 - Changes in Accounting Principles

During the year ended June 30, 2004, the BWL elected the early adoption of GASB No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, to account for impairment related to the Ottawa Station, an idle electric plant and associated land. In accordance with GASB No. 42, the building and land were separately evaluated and an adjustment in the amount of $3,357,350 was recorded to write the Ottawa Station down to its fair value. The idle plant and land remaining on the BWL's books are valued at $948,677 and are included in electric utility plant in the balance sheet.

Note 16 - Ottawa Station Facility

In conjunction with a market value assessment completed during the year ended June 30, 2001 on the Ottawa Station, which is no longer in service, the net assets of the BWL as of July 1, 2002, have been restated to reduce the net book value to fair market value as indicated below:

	Combined	Water	Electric	Steam
Net Assets - July 1, 2002 - As previously reported	$ 425,879,577	$ 82,164,694	$ 326,308,138	$ 17,406,745
Adjustment to lower of cost or market, of the Ottawa Station	(1,970,882)	-	(1,970,882)	-
Net Assets - July 1, 2002 - As restated	$ 423,908,695	$ 82,164,694	$ 324,337,256	$ 17,406,745

Additional Information

Income Available for Revenue Bond Debt Retirement

	Year Ended June 30	
	2004	2003
Income Before Extraordinary Items and Capital Contributions per Statement of Revenues, Expenses, and Changes in Net Assets	$ 2,316,599	$ 18,413,106
Add		
Depreciation expense	29,245,316	24,117,090
Interest on long-term debt:		
Notes	109,621	117,777
Revenue bonds	9,665,402	10,140,516
Total	39,020,339	34,375,383
Income Available for Revenue Bonds and Interest Redemption	**$ 41,336,938**	**$ 52,788,489**
Debt Retirement Pertaining to Revenue Bonds		
Principal	$ 8,405,000	$ 8,471,000
Interest	9,665,402	10,140,516
Total	**$ 18,070,402**	**$ 18,611,516**
Percent Coverage of Revenue Bonds and Interest Requirements	229%	284%

	Combined 2004	Combined 2003	Eliminations 2004	Eliminations 2003
Operating Revenues				
Water	$ 23,066,577	$ 22,347,385	$ -	$ -
Electric:				
Retail	152,335,350	153,671,262	(516,952)	(516,952)
Sales for resale	19,818,668	23,119,882	-	-
Steam	21,513,873	23,319,056	-	-
Total operating revenues	216,734,468	222,457,585	(516,952)	(516,952)
Operating Expenses				
Production:				
Fuel, purchased power, and other operating expenses	106,196,537	111,636,280	(516,952)	(516,952)
Maintenance	19,837,258	18,282,173	-	-
Transmission and distribution:				
Operating expenses	7,445,011	7,242,102	-	-
Maintenance	7,677,096	7,555,454	-	-
Administrative and general	40,458,897	29,836,550	-	-
Depreciation and impairment	29,245,316	24,117,090	-	-
Total operating expenses	210,860,115	198,669,649	(516,952)	(516,952)
Operating Income	5,874,353	23,787,936	-	-
Nonoperating Income (Expense)				
Investment income	209,348	3,565,901	(286,040)	(342,456)
Other income	8,752,650	3,931,814	-	-
System capacity fees	9,331,480	11,274,028	-	-
Bonded debt interest expense	(9,665,402)	(10,140,516)	-	-
Amortization - Central utilities complex	(3,550,000)	(5,160,000)	-	-
Payment in lieu of taxes	(8,526,209)	(8,728,280)	-	-
Other interest expense	(109,621)	(117,777)	286,040	342,456
Total nonoperating expense, net	(3,557,754)	(5,374,830)	-	-
Income (Loss) Before Extraordinary Item and Capital Contributions	2,316,599	18,413,106	-	-
Extraordinary Item				
Change in accounting principle	-	15,257,495	-	-
Income (Loss) Before Capital Contributions	**$ 2,316,599**	**$ 33,670,601**	**$ -**	**$ -**

Detail of Statement of Revenues and Expenses
Years Ended June 30, 2004 and 2003

Water 2004	Water 2003	Electric 2004	Electric 2003	Steam 2004	Steam 2003
$ 23,066,577	$ 22,347,385	$ -	$ -	$ -	$ -
-	-	152,852,302	154,188,214	-	-
-	-	19,818,668	23,119,882	-	-
-	-	-	-	21,513,873	23,319,056
23,066,577	22,347,385	172,670,970	177,308,096	21,513,873	23,319,056
5,634,766	5,631,943	90,962,425	95,763,851	10,116,298	10,757,438
2,217,611	2,267,454	15,838,759	12,879,034	1,780,888	3,135,685
-					
1,709,330	1,454,163	5,614,796	5,655,024	120,885	132,915
1,836,967	2,054,445	5,262,612	4,972,593	577,517	528,416
6,173,104	4,456,465	32,517,250	23,777,362	1,768,543	1,602,723
3,553,895	3,305,220	22,306,285	17,515,746	3,385,136	3,296,124
21,125,673	19,169,690	172,502,127	160,563,610	17,749,267	19,453,301
1,940,904	3,177,695	168,843	16,744,486	3,764,606	3,865,755
(56,687)	632,646	594,555	2,985,242	(42,480)	290,469
1,257,882	1,021,187	7,352,265	3,027,602	142,503	(116,975)
817,438	987,605	7,802,983	9,427,342	711,059	859,081
(1,291,495)	(1,404,725)	(6,331,234)	(6,443,981)	(2,042,673)	(2,291,810)
(310,980)	(452,016)	(2,968,510)	(4,314,792)	(270,510)	(393,192)
(911,457)	(869,041)	(6,766,939)	(6,946,498)	(847,813)	(912,741)
(18,967)	(20,399)	(85,289)	(91,634)	(291,405)	(348,200)
(514,266)	(104,743)	(402,169)	(2,356,719)	(2,641,319)	(2,913,368)
1,426,638	3,072,952	(233,326)	14,387,767	1,123,287	952,387
-	(736,302)	-	16,248,068	-	(254,271)
$ 1,426,638	**$ 2,336,650**	**$ (233,326)**	**$ 30,635,835**	**$ 1,123,287**	**$ 698,116**

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Detail of Statement of Changes in Net Assets

	Combined	Water	Electric	Steam
Net Assets - July 1, 2002 - As restated (Note 16)	$ 423,908,695	$ 82,164,694	$ 324,337,256	$ 17,406,745
Contributions	5,492,448	5,492,448	-	-
Income before contributions	33,670,601	2,336,650	30,635,835	698,116
Net Assets - June 30, 2003	463,071,744	89,993,792	354,973,091	18,104,861
Contributions	3,183,085	3,183,085	-	-
Income before contributions	2,316,599	1,426,638	(233,326)	1,123,287
Net Assets - June 30, 2004	**$ 468,571,428**	**$ 94,603,515**	**$ 354,739,765**	**$ 19,228,148**

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September 3, 2004

Finance Committee
Board of Water and Light - City of Lansing Michigan
Lansing, Michigan

We recently completed our audit of the financial statements of the Board of Water and Light - City of Lansing, Michigan Enterprise Fund (BWL) for the year ended June 30, 2004. During the audit we came upon various issues involving your Organization that we would like to bring to your attention. Following are summaries of our observations and recommendations for your consideration and discussion.

INFORMATION TECHNOLOGY

During our consideration of the BWL's information processing system, we noted the following:

Recommendation

- As defined in the 2003 IT Strategic Plan, custom web-based applications are going to be built to replace and add-on to the mainframe applications. The IT Steering Committee, which has been formed subsequent to the development of the original Plan, should update and agree to the strategic direction outlined in the Plan. The purpose of this activity is to 1) confirm that the direction of the IT Plan is in correlation with the business objectives of the BWL, 2) ensure that proper training and development controls are in place for the migration to the web-based applications, and 3) provide business justification for the project sub-tasks that will be required over the next 2-4 years to complete the migration.

Management's Response: *ITRC's Strategic Plan will be taken to the Steering Committee for review, update, and approval.*

Recommendation

- Management has made significant changes to network perimeter firewalls since the last network security assessment in 2003. While internal testing is performed by qualified staff during implementation, we recommend that an independent network security assessment be performed to provide assurance to management that the Board of Water and Light's perimeter layer is properly protected.

Management's Response: *This is appropriate, but premature. The changes that have been made and are being planned for the next year have all been reviewed and recommended by an outside consultant. We should wait until they are all completed before doing another security assessment. We expect to do this in FY 2006*

INFORMATION TECHNOLOGY (Continued)

Recommendation

- The BWL does have defined procedures for removing access rights as employees leave the Organization; however, there is risk that a terminated employee or temporary contractor may still have access to the system. Human Resources generally notifies IT of any changes in employees (terminations, etc.) as soon as it occurs so that IT can make appropriate access changes. However, management should provide a report to Human Resources with the list of users who have the ability to access the mainframe every six months. Human Resources should compare the list to the current employees and temporary workers to verify that all accounts are valid.

Management's Response: *Management concurs with this recommendation. We also anticipate an improvement – doing an automated comparison of TIP users and Windows users with the HR database of active employees and temps. This will generate a daily report for ITRC to update user IDs as changes get posted. This report exists now but does not include temps. We will make this enhancement by the end of September.*

Recommendation

- The BWL does have a documented IS disaster recovery plan for the mainframe and Haco complex. Procedures have been identified to recover server and mainframe data and IT personnel now have a practical plan for recovery at the Sungard host-site. However, the current documented plan has become outdated and should be updated. The plan should be updated for employee notification, insurance requirements, key contact information, prioritization of activities, rerouting of communications, network equipment and applications. We recommend that the plan be updated and communicated to key personnel. In addition, a procedure for maintaining and updating the disaster recovery plan should also be identified.

Management's Response: *Management acknowledges that the plan needs to be updated. This project will be taken to the Steering Committee and if approved will be planned for in FY2006 budget year. Note: Major changes coming in the next year will have a significant impact on the content of this plan – namely VoIP, unified messaging, and a major upgrade to BWL's WAN which will include higher bandwidth, powered switches, etc.*

INFORMATION TECHNOLOGY (Continued)

Recommendation

- The network and e-mail servers have become increasingly important in supporting business operations. Management has implemented controls to ensure proper security, however, the data backups which provide business continuity allows up to five business days of data could be lost if the facility which hosts the servers and on-site backups are lost in a disaster. We recommend that tapes be rotated to the off-site facility on a daily basis.

Management's Response: *Management concurs with this recommendation and will implement the change when the new backup system is installed this fiscal year. Incremental backups will be stored on disk and FTP'd to a remote site. Full backups will be taken off-site weekly.*

Recommendation

- Management has not defined development standards of the .Net applications. The procedures should provide specific control requirements related to development standards, technical and user testing requirements, and post-implementation monitoring. These controls will reduce the risk that inaccurate and/or inefficient processing will be placed into a production environment. We recommend that tight controls similar to those established for the mainframe be established over the new development process.

Management's Response: *Management concurs. The Steering Committee has approved this work under the project titled 'Configuration Management.'*

Recommendation

- Separation of duties over the network could present an issue as certain individuals have Administrator access with no compensating detective control performed to ensure the validity of actions performed on the network. A similar issue is presented on the mainframe as employees with administrator access would have the ability to change user rights or add new users without a proactive review of audit logs. In order to address this issue we recommend that administrative users maintain two user accounts on the system. The first is their general login for regular business use. The second account is for superuser functions. All logins and activities performed under the superuser accounts should be logged and reviewed for reasonableness. The log needs to be reviewed by someone with a good understanding of the system, but someone who also provides independence (i.e., they cannot maintain administrative access). Management has indicated that this risk will be accepted as the cost of implementing the recommendation exceeds the risk mitigated.

Management's Response: *Management has reviewed this issue and considers the risk acceptable as the cost of implementing the recommendation in our environment is excessive.*

VENDOR/PAYEE SETUP

Recommendation

- All employees who have the authority to create a check requisition to pay a pre-approved vendor also have the ability to request a check for a new payee. New payees are not subject to the approval process which vendor's are subject to. Checks cut to these payees are subject to the same approval guidelines as checks to pre-approved vendors, however, considering the volume of checks the BWL processes and approves for payment, checks made out to inappropriate non-approved payee's could be overlooked. We recommend only pre-approved payees be available for check requisition. Furthermore, in setting up new vendors, currently the only check performed is to verify the vendor is not already in the system. We recommend a more thorough process be implemented to screen new vendors before creating them in the system.

Management's Response: *Management acknowledges there is an issue regarding payees being created by employees with purchasing authority. Procedures will be developed in the upcoming year to ensure that proper controls are implemented to minimize the risk of fraud.*

VAULT ACCESS

Recommendation

- Through our audit testing, we noted that throughout each day, several cashiers and remittance department employees have access to the vault and the vault is not always secured. In addition, individual employees can enter the vault without another employee present. Current procedures consist of one employee closing the vault at night who does not recount or verify the cash in the vault, and another employee opening the vault in the morning and recounting the cash deposit from the previous day. We recommend implementing a control system to limit access to the vault including a requirement for two employees to open, close and access the vault and keeping the vault locked when not in use. In addition to the recount of cash preformed in the morning, we recommend all cash deposits be counted at the end of the day by remittance department employees to verify the totals of the cashiers that created the deposit.

Management's Response: *Management agrees with the recommendation and should implement a control system to limit vault access. By month end, control measures will be utilized.*

STORES INVENTORY ONLINE PROCEDURES

Recommendation

- Currently, departments have the capability of ordering inventory from Stores Inventory online. However, when departments order online, the Stores Inventory is only researched and quantity of the requested inventory items is verified to either be on hand or not available. The inventory items are not segregated for pick up at the time of online ordering. Personnel then go to the Stores Inventory location, employees at Stores verify the inventory is on hand again and separate it for the employee to take. We recommend when inventory is ordered online and the quantity is verified, employees at Stores Inventory pull the inventory items requested to be ready ahead of time for pick up. This would eliminate the duplication of verifying inventory quantities and would increase the efficiency for all departments when picking up inventory at the Stores location.

Management's Response: *Management believes that current warehouse procedures meet this recommendation, with the exception of allocated material requisitions for the Delivery crews. When engineering allocates material to a specific work sketch with a future date, the current procedure is for the sketch to get released to the crew and then the crew comes to the warehouse to pick up the material. There is currently no prior notice for the warehouse staff so material is segregated when the crew arrives. A process improvement would be for the warehouse staff to receive advance notice from the Delivery group that a sketch is going to be released to a crew in the next few days. This would allow the warehouse staff to segregate the item before the crew comes to the warehouse to pick up the material. Our warehouse supervisor has already had preliminary discussions with one of the Managers involved that their sketches will be reviewed, modified, and released at least two days before they will come to the warehouse to pickup the material. This improvement will be implemented this fiscal year.*

COAL INVENTORY CONTROLS

Recommendation

- Currently, coal inventory procurement is heavily concentrated within one individual and that individual has the ability to approve purchases for coal, directly receives shipment verification and approves invoices for payment. We recommend that these processes be separated for improved segregation of duties.

Management's Response: *Fuel Procurement takes the lead in requesting quotations from multiple suppliers of coal and rail services. Process management and the Director of Production review these proposals. They then direct Fuel Procurement to draft contracts for the best-evaluated proposal. These contracts are reviewed by legal and are approved by the General Manager and the Commissioners.*

CONSTRUCTION WORK IN PROGRESS (CIP)

Recommendation

- In our audit of CIP, we noted that the accounting department does not have the ability to generate a report that provides project by project details of costs incurred to support the CIP balance at year end. Rather, amounts incurred and removed from CIP are tracked on an overall basis and are reconciled to the general ledger on a monthly basis. Items removed from CIP each month are identified by project managers in the engineering department. We recommend management develop a system to allow review of the CIP balance on a project by project basis and that oversight of the CIP account be delegated to a member of the accounting staff. This reporting will facilitate monthly evaluation by the accounting department of the projects in CIP including the duration of time projects have remained in CIP, the status of the project through review with project managers, and a determination of whether a portion of the project is complete and should be depreciated. The periodic review with project managers should address the timing of project completion versus expectation, expenditures versus expectation and determine portions of incomplete projects which are functioning and should be depreciated. These procedures would mitigate the risk of projects remaining in CIP at month end that should either be capitalized and depreciated or removed and expensed.

Management's Response: *Management agrees there is a need to review the work order closing procedure. During the year Accounting will work to develop a procedure to review CIP.*

SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, RELATED ISSUES

Recommendation

- Board of Commissioners Resolution 2002-4-8 approved discontinuance of the use of Financial Accounting Standard (FAS) 71. Resolution 2003-8-3 rescinded Resolution 2002-4-8, and among other things, indicated that all future FAS 71 related items to be recorded in the financial statements are required to be approved by the Board of Commissioners prior to their use. The financial statements for the fiscal year ended June 30, 2004 include a FAS 71 asset deferral in the amount of approximately $4.6 million related to the North Lansing landfill environmental remediation. The financial statements for the fiscal year ended June 30, 2004 have been prepared including this FAS 71 deferral based on management's representations that they have addressed this item with the Board and expect that the Board will approve it for FAS 71 treatment.

SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, RELATED ISSUES (Continued)

Recommendation (Continued)

Accounting standards require that construction period interest cost be capitalized as part of the asset being constructed. Our understanding is that in prior years interest has not been capitalized due to the use of FAS 71. Based on review of Resolution 2003-8-3 it is unclear whether the Board of Commissioners has approved interest (other than for the CUC) as an item for FAS 71 treatment. If interest is not intended to be an item for FAS 71 treatment, the result would be certain interest costs incurred during the fiscal year ended June 30, 2004 related to the construction of assets should be capitalized as part of that asset. Interest costs of approximately $1.2 million have been expensed in the current year statements rather than being capitalized as required by accounting standards when FAS 71 is not used. It is our understanding that management intends to clarify its current accounting treatment for this transaction and all transactions subject to FAS 71 accounting during the 2004/2005 fiscal year.

Management's Response: *Management will seek prior, explicit approval from the Board of Commissioners for all applications of FAS 71 during fiscal year 2005.*

RETIREE HEALTH CARE BENEFITS

Recommendation

- The Governmental Accounting Standards Board has recently released Statement Number 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid.

  However, the new pronouncement will require a valuation of the obligation to provide retiree health care benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must be performed by an actuary at least every other year and must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any under funding must be reported as a liability on the government wide statement of net assets.

RETIREE HEALTH CARE BENEFIT (Continued)

Recommendation (Continued)

This statement is effective for fiscal years beginning after December 15, 2006. Remember that planning to make the annual recommended contribution generally requires up to three to six months for an actuarial valuation plus six months lead time to work the numbers into the budget. Therefore, we recommend that you begin the actuarial valuation at least one year prior to the above dates.

Management's Response: *Management currently has an Actuarial Valuation Report completed by and outside consultant every year in February. The report gives Management sufficient information to complete the requirements set in GASB 45.*

We appreciate the cooperation extended to us by the BWL staff during the June 30, 2004 audit. If you would like to discuss any of the above matters, please do not hesitate to contact us.

Very truly yours,

PLANTE & MORAN, PLLC

Douglas Rober, CPA
Partner

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cc: Mr. Dennis McFarland, Senior VP of Finance and Administration